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December 4, 2008

Ms. Teri Takai
Chairperson, Technology Services Board
Office of the State Chief Information Officer
1325 J Street, Suite 1600
Sacramento, CA 95814

Dear Ms. Takai:

Department of Technology Services Rate Report for the Technology Services Board

Per Section 11540(b) of the Government Code, the Department of Finance (Finance) provides the attached report regarding the Department of Technology Services' (DTS) Fiscal Year 2008-09 Billing Rates Package to the Technology Services Board (TSB). The proposed rates for Customer Owned Equipment Managed Services (COEMS) and Print Services appear reasonable and Finance recommends the TSB approve them. However, we note that the proposed rate for Print Services consists of two adjustments over time to achieve full cost recovery. While these adjustments are necessary under the current service model, we support DTS' continuing efforts to find more cost effective ways to provide this service. While the Encryption and E-Fax Services do not have specific rates, the proposal to bill them as pass-through costs is consistent with DTS' rate methodology and we recommend their approval.

Finance notes that this rate package is relatively small in scale (\$1,006,742 in 2008-09 and \$2,717,357 in 2009-10 and thereafter) and that DTS has indicated that it will be submitting a larger, more comprehensive rate package in the near future. Therefore, this rate package, while bringing the rate charged by DTS for COEMS and Print Services closer to balancing revenues and expenditures, does not address the still significant over-recovery and under-recovery occurring in some of the larger service areas. Finance recommends that DTS submit an additional rate package by January 31, 2009 or in time for consideration at the TSB meeting tentatively scheduled for March 25, 2009. Finance expects this rate package will substantially realign rates in those service areas with significant under and over recovery, particularly mainframe and network.

If you have any questions, please contact Helen Woodman at (916) 445-1777, extension 3240, or by e-mail at Helen.Woodman@dof.ca.gov.

Sincerely,

Mark Hill
Program Budget Manager

Enclosures

cc: Honorable Rosario Marin, Secretary, State and Consumer Services Agency
Mr. Andrew Armani, Deputy Secretary, Information Technology, State and Consumer
Services Agency
Mr. P. K. Agarwal, Director, Department of Technology Services
Ms. Melissa Matsuura, Acting Deputy Director, Administration, Department of
Technology Services
Mr. Robert Illa, Budget Officer, Department of Technology Services

Department of Finance
Report to the Technology Services Board:
Department of Technology Services Billing Rates Adjustment FY 2008-09

Introduction

Pursuant to Section 11540(b) of the Government Code, the Technology Services Board (TSB) is required to approve the Department of Technology Services (DTS) rate methodology and evaluate the rates DTS charges its customers for services. In addition, Section 11540(b) also requires the Department of Finance (Finance) to prepare a report to the TSB evaluating the reasonableness of the proposed rates and any significant impact the rates are likely to have upon the budgets of other departments. To assist the TSB in evaluating the rate package, we respectfully submit this report based upon our review of DTS' initial proposal and supplemental information provided during our review.

This rate package continues DTS' goal of overall rate consolidation resulting in a merging of rates between the Cannery and Gold Camp campuses and alignment of existing rates so that the rate charged for each service is as close to breakeven as possible. This package contains rates for services for which DTS has projected a revenue increase of \$1,006,742 in Fiscal Year 2008-09 and \$2,717,357 for 2009-10 and annually thereafter. In the cover letter to the rate package, DTS indicates it will be providing a memorandum which will include an analysis of 2007-08 and projected 2008-09 revenues and expenses. The analysis will contain recommendations for rate changes to address continued DTS under-recovery. DTS has communicated to Finance that they anticipate submitting this memorandum to Finance Budgets by the middle of December 2008. DTS has also indicated that it will be submitting a rate package in the near future which will be larger in scope and encompass services which have a greater effect on DTS revenues.

Background

DTS receives expenditure authority through the Budget Act, provisional language, or other legislation, and recovers all actual expenditures by billing client agencies for services. DTS operates from the Department of Technology Services Revolving Fund, which is subject to appropriation by the Legislature.

Section 11540(b) of the Government Code requires that rates be "based on a formal rate methodology approved by the board". At the January 16, 2007 quarterly meeting, the TSB approved the rate methodology developed by DTS to adjust existing rates and develop new rates. This methodology was applied to the rates in this package.

2008-09 Proposed Billing Rate Changes

The proposed rate package, if approved, will become effective January 1, 2009. The following is a summary of the service offerings and rates impacted by this package:

- **Customer Owned Equipment Managed Services (COEMS).** This service provides a secure place for customers to physically house their hardware (generally servers) as opposed to locating it onsite in standard office space. COEMS offers a physically secure environment, including fire detection and suppression, redundant power sources, a high-speed network backbone, and 24x7 remote support to assure high availability of the customer equipment. Currently, customers pay a monthly rate for a locked cabinet, either DTS or customer owned, plus additional services. The current rate does not fully recover the cost of providing the service and the rate package states these rates have not been adjusted since October 2004. DTS proposes to raise the rate from \$300 to \$830 for a full, DTS owned cabinet and to eliminate the half cabinet service for new

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customers. The rate for a customer owned cabinet would be raised from \$230 to \$720. A charge of \$545 per cabinet per month would be introduced to reserve floor space. A charge of \$4 per square foot of office space would be initiated for projects that locate staff at DTS as well as equipment. This rate would go into effect January 1, 2009 and increase COEMS revenue by \$77,981 per month.

- **Print Services.** DTS currently provides its customers with print services including printing on customer provided or DTS forms using impact, laser or continuous form printers. This is a vendor provided service and DTS couriers the printed materials to DTS campuses for delivery to customers, either by DTS courier or customer pick-up. This service operates 24 hours a day, 7 days a week. According to the rate package, rates for print services have not been adjusted since 1997 and raising the rates will bring the service to a 66 percent under-recovery status. DTS proposes to increase all print services rates by 100 percent effective January 1, 2009, and proposes an additional increase of from 31 – 166 percent (depending on the service) July 1, 2009 to reach full cost recovery. These two rate increases equate to an increase in per page cost to the customer from \$.029 to \$.14 - \$.19 for the various types of forms. The rate for labels will be raised from \$.0964 per page to \$.145 effective January 1, 2009 increasing to \$.19 effective July 1, 2009. A rate for "burst and trim" will be introduced at \$.03 per foot effective January 1, 2009, increasing to \$.08 per foot July 1, 2009. The revenue increase to DTS from print services is projected to be \$538,846 for the last six months of FY 2008-09 and \$1,781,609 for FY 2009-10.
- **E-Fax.** DTS proposes to offer e-fax¹ as an optional enhancement to DTS statewide email customers. The rate for this service would be determined on a case by case basis. Customers would be charged according to the cost of standing up the service for that particular customer based on their specific needs.
- **Encryption.** DTS also proposes to offer email encryption as an optional enhancement to DTS statewide email customers. The rate for this service would be determined on a case by case basis. Customers would be charged according to the cost of standing up the service for that particular customer based on their specific needs.

Analysis of the 2008-09 Proposed Billing Rate Changes

Based on our review of the current rate package and supplemental information provided by DTS, it appears that the proposed changes will assist in aligning the rates for the services listed above and bring DTS closer to its goal of balancing revenues and expenditures by service area. Therefore, the proposed rate changes appear reasonable. This rate package did not include an analysis of the impact of this rate package on DTS projected revenues, as was included in prior rate packages along with a discussion of DTS' overall under and over recovery in certain service areas. Therefore we cannot comment on the impact of this rate package on DTS revenues and expenses or the degree to which over and under recovery is still taking place. DTS indicated in the cover letter to this rate package that an analysis of the 2007-08 and 2008-09 revenues and expenses will be provided in a separate memorandum.

In addition, we would note the following:

- **COEMS.** It is difficult to assess the exact degree of COEMS under-recovery for the following reasons, which DTS provided in conjunction with the rate package:

¹ E-fax allows DTS email customers to send documents via email to a fax machine, and to receive faxed documents in their email inbox.

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- Prior to data center consolidation in 2005, the Gold Camp and Cannery Campuses (then known as the Teale Data Center and the Health and Human Services Data Center (HHSDC) respectively) accumulated COEMS related expenses differently from each other, and HHSDC charged a token rate or did not charge some COEMS customers at all.
- After consolidation, charge-backs were made in some months to recover expenses which should have been captured previously, resulting in the appearance of over-collection in some months.
- Manual processes resulted in some costs not being captured, or captured incorrectly.
- Some costs, such as staffing, may still not be fully collected.

Given the above information combined with the relatively small overall impact (\$77,981 per month) of adjusting this rate, we do not believe it would be constructive to attempt to quantify previous under-collections more precisely.

We encourage DTS in its efforts to be more comprehensive and thorough in its accumulation of costs, and to adjust the COEMS rate as necessary as DTS vacates the Cannery site as part of its relocation strategy, and acquires new raised floor space. We would also note that although DTS states that it has received "numerous requests" for COEMS estimates, it is unclear how the proposed rates could affect customer interest in the service.

- **Print Services.** DTS has indicated that it is considering in-sourcing this function to the Employment Development Department (EDD) or to another state agency (currently this function is outsourced to a vendor). DTS has concerns with continuing to outsource this function due to Government Code 19130² which addresses contracting out functions which could be performed by civil servants. We recommend that DTS research the solution and per page charge being paid by state agencies that do a very high volume of printing, such as the Department of Social Services' Statewide Automated Welfare System Consortia.
- **E-Fax and Encryption.** We support the inclusion of e-fax and encryption as enhancements to the existing Statewide Email service offering. Because DTS proposes to outsource these optional services, they should not require a significant investment of infrastructure or staffing resources. As such, the proposed offerings appear to present little financial risk to DTS, while allowing them to provide additional functionality to customers who have a need for such services. We would also note that no actual rate is included in the rate package. Instead, DTS proposes to pass through the cost of standing up the service for those customers that request it.

Analysis of the Significant Impacts on the Budgets of Other Departments

If the current rate changes are approved, the impact of the rate changes on customers that are substantial users of the services is reflected in the tables below. These tables summarize the customers most significantly impacted by the current proposal in 2008-09 and 2009-10. According to DTS, they have informed the Customer Council of the proposed rate changes and have not been informed of any significant customer concerns.

DTS has divided the customer impact into two time periods. The first is for January through June, 2009 to capture the remainder of Fiscal Year 2008-09 when the proposed rate

² See Dept. of General Services Management Memo 07-06 "Contracts for Printing" (http://www.documents.dgs.ca.gov/osp/sam/memos/MM07_06.pdf).

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increase for COEMS and one of the print services rate increases would go into effect. The second time period is for Fiscal Year 2009-10 and includes the second print services rate increase.

**Customer Impact 2008-09: COEMS and Print Services
Customers with 6 Month Difference³ Greater than \$10,000**

Customer	Monthly COEMS	Monthly Print	6 Month Difference
Caltrans	\$42,322	\$10,989	\$319,866
Dept. of Health Care Services	\$17,686	\$21,549	\$235,410
Dept. of Social Services		\$18,395	\$110,370
Dept. of Finance, CALSTARS		\$17,399	\$104,394
California Highway Patrol		\$7,459	\$44,754
Dept. of Developmental Services		\$5,614	\$33,684
Dept. of Social Services - ISAWS	\$4,056		\$24,338
UCSF – Medical Center	\$3,920		\$23,520
Student Aid Commission	\$2,450		\$14,700
California Horse Racing Board		\$1,884	\$11,304

³ "Difference" refers to the difference between what the DTS customer is paying now and will be paying. It is **not** the total amount the customer will be paying.

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**Customer Impact 2009-10: COEMS and Print Services
Customers with 12 Month Difference⁴ Greater than \$20,000**

Customer	Monthly COEMS	Monthly Print	12 Month Difference
Caltrans	\$42,322	\$17,463	\$717,420
Dept. of Health Care Services	\$17,686	\$40,970	\$703,872
Dept. of Social Services		\$25,537	\$306,444
Dept. of Finance, CALSTARS		\$24,674	\$296,088
California Highway Patrol		\$12,730	\$152,760
Dept. of Developmental Services		\$11,799	\$141,588
Dept. of Social Services - ISAWS	\$4,056		\$48,677
UCSF – Medical Center	\$3,920		\$47,040
California Horse Racing Board		\$3,628	\$43,536
Alcoholic Beverage Control	\$190	\$3,402	\$43,104
Student Aid Commission	\$2,450	\$2	\$29,424

Based on the tables above, the proposed changes will increase a small subset of DTS' customer costs to some degree. The largest increases will be experienced by departments utilizing the DTS Print Service (with the exception of Caltrans⁵ which will experience the majority of its rate increase in COEMS). DTS has indicated that they expect print costs to decrease if they in-source printing to EDD, but are not able to provide written confirmation at this time.

In prior rate packages for 2006-07 and 2007-08, customers were able to utilize Control Section 15.25 to offset increased rates, as long as the overall impact on the General Fund was neutral. That is, the aggregate savings due to reduced rates was equal to or greater than the aggregate rate increases. As there are no rate decreases in this package, Control

⁴ "Difference" refers to the difference between what the DTS customer is paying now and will be paying.

⁵ Caltrans has a unique arrangement, currently paying \$12,398 per month for 1,512 square feet of floor space. They will be converted to 76 cabinets at the customer owned cabinet rate of \$720 per cabinet (\$54,720 per month). The difference between \$54,720 and current payment of \$12,398 is the \$42,322 shown in the tables above.

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Section 15.25 cannot be used to offset rate increases for departments funded by the General Fund. It is possible that departments that utilize special funds or other funding sources can receive augmentations provided the affected fund has sufficient resources.

Of the departments listed in the tables above, some have no General Fund, some (primarily in the Health and Human Services Agency) have significant portions that are General Fund (30 – 50 percent), and one budget (Student Aid Commission) is almost entirely General Fund. Imposing a rate increase in current year without a budget adjustment for the General Fund component may be difficult for departments supported by a significant portion of General Fund.

Recommendations

The following recommendations from the previous rate package are still applicable:

- DTS should work with the TSB to develop a schedule for developing future rate packages to include the number of packages and the period of time it will take to materially if not completely align DTS' rates with the cost of providing the services. Finance recognizes that DTS needs to maintain sufficient reserves to cover daily operating expenses and invest in new services.
- DTS should work with Finance to develop a template for future rate packages so that there is a consistent presentation of the information necessary for Finance to perform its evaluation. Consistent presentation of data will ensure the impact of the rates is determined in a constant, repeatable manner and reduce the amount of time spent in the initial interpretation of the rate packages.

Recommendations specific to this rate package:

- Based on our analysis, the rate proposed for COEMS appears reasonable. The rates proposed for Print Services appear high and DTS may want to research costs being paid by departments that do a high volume of printing before adjusting this rate further. While the Encryption and E-Fax Services do not have specific rates, billing them as pass-through costs is consistent with DTS' rate methodology and we have no further concerns.
- We recommend the TSB approve the rates for COEMS and Print Services, and the pass-through methodology of billing for the cost of E-Fax and Encryption Services.

Conclusion

At this time, and assuming that customers continue existing usage patterns, it appears that the proposed rate changes for COEMS and Print Services are acceptable. We recognize the challenges DTS faces in initiating new services and establishing a consolidated rate strategy and are supportive of their continued efforts. We also recognize that DTS is facing ongoing challenges in revenue collection while attempting to reduce under and over recovery in some of its service areas, and appreciate that this situation will take some time to stabilize.